Bank of Melbourne

Monday, 26 August 2019

Market Turbulence Continues

When the US President demands that US companies “immediately start looking for an alternative to China”, you know that trade relations are getting increasingly frosty. The trade conflict between the US and China took another turn for the worse over the weekend. Trump’s tweet was accompanied by yet another round of tariff increases on Chinese imports to the US. From October 1, $250 billion worth of imports from China currently facing a 25% tariff will be increased to 30%, and the remaining $300 billion worth of imports will be tariffed at 15% from September 1, up from 10%. The announcement comes after China unveiled an increase of tariffs on $75 billion worth of US goods.

The risks from trade developments and political risks in general, were front and centre of discussions at the central bank conference in Jackson Hole over the weekend. While there was a clear indication from Federal Reserve Chair Powell that the Federal Reserve would “act as appropriate,” central banks were in unison in regards to the limitations of monetary policy in addressing the risks. Powell made specific mention of trade uncertainty and that there were “no recent precedents to guide any policy response to the current situation. Moreover, while monetary policy is a powerful tool that works to support consumer spending, business investment and public confidence, it cannot provide a settled rulebook for international trade.” In regards to these political shocks, RBA Governor Lowe said they were turning into economic shocks, but added that “there is a strongly-held view that the central bank should just fix the problem… The reality is much more complicated”.

The comments are not so reassuring for markets this week, which are likely to continue to be buffeted by trade developments. Meanwhile, markets will still need to contend with other political risks around the world including Hong Kong, Brexit in the UK and inflamed tensions with Iran.

In terms of economic data, the calendar fills up this week with the roll out of partial economic indicators ahead of the June quarter GDP data next week. Construction work done is slated for Wednesday, while private capital expenditure is due to be released on Thursday. We are expecting to see further evidence of a residential construction downturn, but the key uncertainty is business investment. Spending plans for 2019-20 have so far been positive, but the loss of momentum in the global economy and sustained falls in business confidence suggest that there is some risk that spending plans will not be so robust, particularly within non-mining sectors. Nonetheless, the resilience in commodity prices should support mining investment, where there is increasing evidence that the multi-year downturn is now behind us. Among other data, building approvals and private sector credit will be released on Friday.

Forecasts

	2019			2020			
End Period:	**Close (Aug 23)**	**Q3 (f)**	**Q4 (f)**	**Q1 (f)**	**Q2 (f)**	**Q3 (f)**	**Q4 (f)**
Aust. Interest Rates:							
RBA Cash Rate, %	1.00	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW, %	0.99	0.95	0.85	0.70	0.70	0.70	0.70
3 Year Swap, %	0.69	0.70	0.70	0.75	0.80	0.85	0.90
10 Year Bond, %	0.97	0.90	0.90	1.00	1.00	1.10	1.10
US Interest Rates:							
Fed Funds Rate, %	2.125	1.875	1.375	1.375	1.375	1.375	1.375
US 10 Year Bond, %	1.54	1.60	1.55	1.60	1.60	1.65	1.65
USD Exchange Rates:							
AUD-USD	0.6756	0.67	0.67	0.66	0.66	0.67	0.67
USD-JPY	105.39	106	106	107	108	110	111
EUR-USD	1.1144	1.09	1.08	1.08	1.08	1.09	1.11
GBP-USD	1.2266	1.18	1.19	1.20	1.22	1.24	1.26
NZD-USD	0.6405	0.64	0.64	0.63	0.63	0.64	0.64
AUD Exchange Rates:							
AUD-USD	0.6756	0.67	0.67	0.66	0.66	0.67	0.67
AUD-EUR	0.6063	0.61	0.62	0.61	0.61	0.61	0.60
AUD-JPY	71.22	71.0	71.0	70.6	71.3	73.7	74.4
AUD-GBP	0.5502	0.57	0.56	0.55	0.54	0.54	0.53
AUD-NZD	1.0552	1.05	1.05	1.05	1.05	1.05	1.05

	2018	**2019 (f)**	**2020 (f)**
GDP, %	2.4	2.2	2.5
CPI (Headline), %	1.8	1.7	1.9
CPI (Trimmed mean), %	1.9	1.5	1.8
Unemployment Rate, %	5.0	5.4	5.6
Wages Growth, %	2.3	2.5	2.6

AUD cross exchange rates have been rounded.

Financial forecasts are quarter end.

GDP, CPI, employment and wage growth forecasts are year end.

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